

Danone

Price EUR67.93

Good H1 results, but weak visibility going forward

Fair Value EUR67 (-1%)

NEUTRAL

Yesterday, Danone posted a good set of results that showed strong improvement in the EBIT margin and gradual recovery of Dairy. However, we think the visibility remains weak. We have doubts about Water and Baby food in China and the rationale of the WhiteWave acquisition. We fine tune our estimates, but maintain our Neutral recommendation and our Fair Value of EUR67.

ANALYSIS

- **A good set of results, helped by one offs.** Q2 organic sales were up 4.1%, above the Q1 trend (+3.5%) mainly thanks to an acceleration by Dairy and Early life nutrition. The EBIT margin increased 125bps in reported terms and 93bps organically to 13.37%. This was above forecasts (consensus: 12.92% and our estimate: 13.15%), thanks to the Early Life Nutrition division (+353bps in organic) which benefitted from easy comps (a fire in a factory and the dumex adaptation costs in H1 2015) and the decline in prices of milk powder.
- **Dairy on the right track. Yoghurts posted 3% organic sales growth in Q2, above the Q1 trend (+2.3%).** Surprisingly, volumes dropped 2.2%, in line with Q1 (-2.1%), due to the decline in low value-added segments in CIS as part of the group's strategy to premiumise its portfolio. **The acceleration in OSG was driven by Europe which dropped low single digit, improving vs Q1.** The group said that the relaunch of Actimel and Danonino have started to pay off. Both brands were back to positive sales growth in H1. Danone will relaunch Activia at the end of Q3. The United States enjoyed very good momentum, with organic sales up mid single in Q2 and in Q1, partly thanks to successful innovations and investments behind the brands.
- **Continuing difficulties for Mizone in China. Destocking of Mizone in China (7% of the group's EBIT) is not over at the end of H1.** We had flagged that risk in our paper dated June 15th. **The company said that growth in the market for non-alcoholic beverages in the country is now flat to low single digit.** When it released its 2015 results, the market's growth was running at 5-10% and Mizone was expecting to return to this pace of growth.
- **Regulatory issues on Baby Food in China.** Danone said that, as a result of the regulation of cross border e-commerce, traders are currently in a wait-and-see mode and may be transferring part of their business from Europe to Oceania. The group is accelerating the conversion from indirect to direct sales. **It indicated that the baby food market in China is up low to mid single digit.** In July 2015 when we initiated the coverage of the company, **Euromonitor was expecting the market to grow annually by 22% on average (16% on average in volume).**
- **Fine tuning estimates.** We now expect **3.4% organic sales growth in 2016 (vs 3.2% previously).** In Q3, organic sales should decelerate vs H1. Our estimate calls for +2.6%. This should be driven by 1/ Yoghurts impacted by tough comps and weak momentum in CIS and ALMA and 2/ regulation in Chinese Early life nutrition. In Q3, Waters should continue to grow around 3% due to tough comps, flooding in China and ongoing destocking of Mizone. **We expect the EBIT margin to rise 66bps to 13.6%, with +51bps in organic, +6bps due to FX and +10bps due to perimeter.**

VALUATION

- At yesterday's share price, the stock is trading at 22.3x P/E 16e and 20.3x P/E 17e, +2% and -1% vs the peers' average.

NEXT CATALYSTS

- Nestlé: H1 2016 results due on August 18th

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	Bloomberg	BN FP
Reuters		DANO.PA
12-month High / Low (EUR)		67.9 / 53.1
Market Cap (EUR)		44,555
Ev (BG Estimates) (EUR)		62,954
Avg. 6m daily volume (000)		1 669
3y EPS CAGR		8.8%

	1 M	3 M	6 M	31/12/15
Absolute perf.	11.5%	8.5%	10.9%	9.1%
Food & Bev.	4.8%	3.0%	3.4%	0.0%
DJ Stoxx 600	7.2%	-2.7%	1.4%	-7.2%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	22,412	21,911	26,315	27,678
% change		-2.2%	20.1%	5.2%
EBIT	2,892	2,985	3,631	3,982
% change		3.2%	21.7%	9.7%
Net income	1,791	1,874	2,061	2,323
% change		4.6%	10.0%	12.7%

	2015	2016e	2017e	2018e
Operating margin	12.9	13.6	13.8	14.4
Net margin	8.0	8.6	7.8	8.4
ROE	10.2	14.7	16.0	16.6
ROCE	11.0	12.4	14.5	15.5
Gearing	61.6	141.8	127.9	113.7

(EUR)	2015	2016e	2017e	2018e
EPS	2.93	3.04	3.35	3.77
% change	-	3.8%	10.0%	12.7%
P/E	23.2x	22.3x	20.3x	18.0x
FCF yield (%)	3.7%	3.8%	4.1%	4.5%
Dividends (EUR)	1.60	1.66	1.83	2.06
Div yield (%)	2.4%	2.4%	2.7%	3.0%
EV/Sales	2.3x	2.9x	2.4x	2.2x
EV/EBIT	18.1x	21.1x	17.2x	15.5x



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